

**Taxpayer Rights to Appeal
Federal Tax Liens Were Protected**

November 2002

Reference Number: 2003-40-025

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

November 21, 2002

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

Gordon C. Milbourn

FROM: Gordon C. Milbourn III
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Taxpayer Rights to Appeal Federal Tax
Liens Were Protected (Audit # 200240056)

This report presents the results of our review to determine if the Internal Revenue Service (IRS) took appropriate corrective actions to assure taxpayer rights were not violated for the cases identified with potential legal violations in the Treasury Inspector General for Tax Administration's (TIGTA) Fiscal Year (FY) 2000 and 2001 reviews¹ of the IRS' compliance with 26 United States Code (U.S.C.) § 6320 (Supp. IV 1998).²

When initial contacts by the IRS do not result in the successful collection of unpaid tax, the IRS has the authority to attach a claim to the taxpayer's assets for the amount of unpaid tax liabilities.³ Since January 19, 1999, 26 U.S.C. § 6320 has required the IRS to notify taxpayers in writing within 5 business days of the filing of a Notice of Federal Tax Lien (NFTL). Taxpayers have 30 days to request a hearing with the IRS' Office of Appeals to appeal the filing of the NFTL.

The TIGTA is required to determine annually whether NFTLs filed by the IRS comply with the legal guidelines in 26 U.S.C. § 6320. The TIGTA identified 33 cases with potential legal violations of taxpayer rights during its FY 2000 and 2001 reviews and recommended that appropriate actions be taken to protect the appeal rights of the

¹ *Compliance With Requirements for Notifying Taxpayers of Federal Tax Lien Filings Has Not Yet Been Achieved* (Reference Number 2000-10-152, dated September 2000); and *Full Compliance With Requirements for Notifying Taxpayers of Federal Tax Lien Filings Has Not Yet Been Achieved* (Reference Number 2001-10-127, dated August 2001).

² 26 U.S.C. § 7803(d)(1)(iii) (Supp. IV 1998).

³ 26 U.S.C. § 6321 (1994).

taxpayers affected.⁴ The IRS agreed to take the appropriate action for each of the cases identified.

In summary, the IRS took appropriate corrective action in 91 percent (30 of 33) of the cases identified in the TIGTA's FY 2000 and 2001 reviews. The IRS has advised us that corrected lien notices either have been or will be issued for the three remaining cases. None of the taxpayers associated with the 33 cases identified had their right to appeal the NFTL improperly denied. Consequently, the TIGTA is not making any recommendations related to this review.

Management's Response: The IRS responded that it was glad the TIGTA recognized the steps the IRS is taking to protect taxpayer rights. The IRS stated that it would continue to identify and take the necessary actions to adequately protect the taxpayers' right to appeal a Federal tax lien. The IRS also stated that it had issued new lien notices for the three cases where corrective action was not originally taken. Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have any questions or Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 927-0597.

⁴ In FYs 2000 and 2001, the TIGTA reported 35 cases as having potential violations of taxpayer rights. Since then, the IRS and the TIGTA agreed that 2 of the 35 had no potential violations.

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Taxpayer Rights to Appeal Federal Tax Liens Were Protected

Background

When initial contacts by the Internal Revenue Service (IRS) do not result in the successful collection of unpaid tax, the IRS has the authority to attach a claim to the taxpayer's assets for the amount of unpaid tax liabilities.¹ This claim is referred to as a Federal Tax Lien.

Since January 19, 1999, 26 United States Code (U.S.C.) § 6320 (Supp. IV 1998)² has required the IRS to notify taxpayers in writing within 5 business days of the filing of a Notice of Federal Tax Lien (NFTL).³ The IRS is required to notify taxpayers the first time a NFTL is filed for each tax period. The *Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320*⁴ (lien notice) is used for this purpose and advises taxpayers that they have 30 days to request a hearing with the IRS' Office of Appeals. The lien notice will indicate the date this 30-day period expires. A synopsis of the IRS' collection and lien filing processes is included in Appendix IV.

The Treasury Inspector General for Tax Administration (TIGTA) is required to determine annually whether NFTLs filed by the IRS comply with the legal guidelines set forth in 26 U.S.C. § 6320.

In its Fiscal Year (FY) 2000 and 2001 reviews,⁵ the TIGTA recommended that appropriate actions be taken for 33 cases⁶ to protect the appeal rights of the taxpayers affected. The IRS agreed to take corrective action for each of the identified cases. For those cases where the taxpayer or the taxpayer's business partner did not receive the lien notice,

¹ 26 U.S.C. § 6321 (1994).

² 26 U.S.C. § 7803(d)(1)(A)(iii) (Supp. IV 1998).

³ *Notice of Federal Tax Lien Under Internal Revenue Laws*, Form 688-F (Rev.2-1985), Cat. No. 164R.

⁴ *Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320*, Letter 3172 (DO) (01-2000).

⁵ *Compliance With Requirements for Notifying Taxpayers of Federal Tax Lien Filings Has Not Yet Been Achieved* (Reference Number 2000-10-152, dated September 2000); and *Full Compliance With Requirements for Notifying Taxpayers of Federal Tax Lien Filings Has Not Been Achieved* (Reference Number 2001-10-127, dated August 2001).

⁶ In FYs 2000 and 2001, the TIGTA reported 35 cases as having potential violations of taxpayer rights. Since then, the IRS and the TIGTA agreed that 2 of the 35 had no potential violations.

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issuing the notice would have been the appropriate action. Appropriate action for those lien notices that were not sent timely would be the re-issuance of the notice to show the appropriate 30-day appeal period.

At the conclusion of the FY 2000 and 2001 reviews, the TIGTA provided the IRS with specific information on each lien notice identified with potential legal violations. The IRS sent this information to the responsible field offices. The IRS National Headquarters provided information outlining the violations for each case and the appropriate corrective action for the potential legal violations identified. The field offices certified that corrective actions were taken.

We performed our audit work between June and September 2002. This audit was performed in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Appropriate Action Was Taken to Protect Taxpayer Rights

The IRS took appropriate action to protect taxpayers' right to appeal an NFTL in 91 percent (30 of 33) of the cases the TIGTA identified in its FY 2000 and 2001 reviews. The IRS advised the TIGTA that corrected lien notices either have been or will be issued for the three remaining cases. In addition, none of the 33 taxpayers affected had their right to appeal the NFTL improperly denied.

In FYs 2000 and 2001, the TIGTA identified 33 cases with potential violations of taxpayer rights. In these 33 cases, the taxpayer either was not sent the lien notice, the lien notice was not sent within 5 days of the filing of the NFTL, or the taxpayer's business partner was not sent the lien notice. In all cases, taxpayer rights to appeal the NFTL could have been adversely affected.

The IRS did not take appropriate corrective action for 3 of the 33 cases (9 percent). These cases were reported to the IRS in FY 2000 because the lien notices were not mailed to the taxpayer within 5 business days of the filing of the NFTL.

- For 2 of the 3 lien notices, IRS field office employees miscalculated the 5-day period between the dates the NFTLs were filed and the dates of the lien notices,

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causing them to conclude that the lien notices did not need to be reissued. The field office certified that no corrective action was needed and the IRS National Headquarters relied on that certification.

- For one of the three lien notices, employee oversight prevented the lien notice from being reissued. In this instance, the IRS field office provided a mass certification that corrective action had been taken on all liens provided to that office. Again, the IRS National Headquarters relied on the field office's certification.

The IRS National Headquarters subsequently agreed that the lien notices for these three cases should be reissued, and has advised us that the notices either have been or will be reissued.

The lien notice informs the taxpayer of the date the 30-day period to request a hearing expires. The IRS can disallow a request for hearing if the request is made after the 30-day appeal period has ended. None of the taxpayers impacted by the 33 cases identified in FYs 2000 and 2001 with potential legal violations requested a hearing to appeal the NFTL.

Since the IRS' process for identifying and taking corrective action adequately protects taxpayers' right to appeal an NFTL, the TIGTA is not making any recommendations related to this review.

Management's Response: Although the TIGTA did not make any recommendations, the IRS responded that it would continue to identify and take the necessary actions to adequately protect the taxpayers' right to appeal a Federal Tax Lien. The IRS also stated that it had issued new lien notices for the three cases where corrective action was not originally taken.

Detailed Objective, Scope, and Methodology

The objective of this audit was to determine if the Internal Revenue Service (IRS) took appropriate corrective actions to assure taxpayer rights were not violated for the cases identified with potential violations in the Treasury Inspector General for Tax Administration's (TIGTA) Fiscal Year (FY) 2000 and 2001 reviews¹ of the IRS' compliance with 26 United States Code (U.S.C.) § 6320 (Supp. IV 1998).² To accomplish the objective, we did the following.

- I. Discussed procedures for processing collection due process hearing requests with the IRS National Headquarters Technical and Insolvency Unit.
- II. Reviewed the process established by the IRS for ensuring that corrective actions were taken on potential legal issues identified by the TIGTA in the FY 2000 and 2001 reviews. Specifically, we:
 - A. Obtained copies of memorandums issued to IRS field offices addressing corrective actions on FY 2000 and 2001 potential legal exception cases.
 - B. Obtained copies of certifications returned by field office managers showing that corrective actions were taken; and followed up with the IRS National Headquarters Technical and Insolvency Unit, for all cases that did not have a certification, to determine if corrective action was not taken or why the action was not certified.
 - C. Evaluated corrective actions taken by the IRS to determine if taxpayer rights to appeal the Notice of Federal Tax Lien were protected.
- III. Identified and reviewed the 33 cases identified by the TIGTA in FYs 2000 and 2001³ and researched the appropriate IRS data systems to determine if lien notices were reissued and if the taxpayers had requested but were denied due process hearings.
- IV. Followed up with the IRS National Headquarters Technical and Insolvency Unit to determine why corrective actions were not taken on 3 of the 33 cases.

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² 26 U.S.C. § 7803(d)(1)(A)(iii) (Supp. IV 1998).

³ In FYs 2000 and 2001, the TIGTA reported 35 cases as having potential violations of taxpayer rights. Since then, the IRS and the TIGTA agreed that 2 of the 35 cases had no potential violations.

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Synopsis of the Internal Revenue Service Collection and Lien Filing Processes

The collection of unpaid tax begins with a series of letters (notices) sent to the taxpayer advising of the debt and asking for payment of the delinquent tax. The Internal Revenue Service's (IRS) computer systems are programmed to mail these notices when certain criteria are met. If the taxpayer does not respond, the account is transferred for either personal or telephone contact.

- IRS employees who make personal (face-to-face) contact with taxpayers are called revenue officers and work in the IRS area offices. The computer system used in most of the area offices to track collection actions taken on taxpayer accounts is called the Integrated Collection System (ICS).
- IRS employees who make only telephone contact with taxpayers work in call sites in IRS Customer Service offices. The computer system used in the call sites to track collection actions taken on taxpayer accounts is called the Automated Collection System (ACS).

When these efforts have been taken and the taxpayer has still not paid the tax liability, designated IRS employees are authorized to file a Notice of Federal Tax Lien (NFTL). Liens protect the government's interest by attaching a claim to the taxpayer's assets for the amount of unpaid tax liabilities. The right to file an NFTL is created by 26 United States Code § 6321 (1994) when:

- The IRS has made an assessment and given the taxpayer notice of the assessment, stating the amount of the tax liability and demanding payment.
- The taxpayer has neglected or refused to pay the amount within 10 days after the notice and demand for payment.

When designated employees request the filing of an NFTL using either the ICS or the ACS, the NFTL requests from both systems are transferred to the Automated Lien System (ALS). All NFTLs are processed by the ALS unless there is an expedite situation, in which case the NFTL is manually prepared. Although they are manually prepared, manual NFTLs are tracked and controlled on the ALS. The ALS maintains an electronic database of all open NFTLs and updates the IRS' primary computer records to indicate that an NFTL has been filed.

Most lien notices are mailed to taxpayers by certified or registered mail rather than being delivered in person. To maintain a record of the notices, the IRS prepares a certified mail listing (Postal Service Form 3877) which identifies each notice that is to be mailed. The notices and a copy of the certified mail listing are delivered to the United States Postal Service. A postal employee ensures that all notices are accounted for, then date stamps the listing and returns a copy to the IRS. The stamped certified mail listing is the only documentation the IRS has that

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certifies the date the notices were mailed. The IRS guidelines require that the stamped certified mail listing be retained for 10 years after the end of the processing year.

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Appendix V

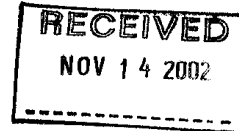
Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/Self-EMPLOYED DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

NOV - 8 2002



MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Joseph G. Kehoe
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Internal Audit Report – Taxpayer Rights to Appeal
Federal Tax Liens Were Protected (Audit 200240056)

I have reviewed your draft report, and am glad you recognized the steps we are taking to protect taxpayer rights. Although you made no recommendations, I assure you we will continue to identify and take the necessary actions to adequately protect the taxpayers' right to appeal a Federal tax lien.

I applaud the hard work of our employees who have made significant progress in their efforts to fully protect the rights of every taxpayer. Managers have provided additional lien collection due process training and reviewed the Internal Revenue Manual to ensure that all employees are aware of their responsibilities.

As you are aware, of the 245,192 liens in your sample size, your review identified 33 lien cases having potential violations and the report stated we did not complete actions on three cases. Originally, we did not take corrective actions on two of the cases because of a miscalculation in the five business day response period. We retrained the responsible employees and issued new notices. We missed the remaining case during the corrective action process. We have corrected the oversight and issued a new notice in this case.

We will continue to stress the importance of protecting taxpayers' rights and appreciate the opportunity to comment on your review. If you have any questions, please contact Joseph R. Brimacombe, Deputy Director, Compliance Policy, Small Business/Self-Employed Division at (202) 283-2200.